

**BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001**

TRANSFERRING FIRST-CLASS MAIL PARCELS)
TO THE COMPETITIVE PRODUCT LIST) Docket No. MC2015-7

**COMMENTS OF GAMEFLY, INC.
(December 17, 2014)**

Pursuant to Order No. 2255, GameFly, Inc., respectfully submits these comments on the Postal Service's November 14 Request in this docket.¹ GameFly is concerned mainly with the precedential effect of this case on other pending or future product transfer cases if the Commission were to adopt the competitive theories advanced by the USPS here.

The evidence of competition offered by the USPS in the present docket does not begin to satisfy the Postal Service's burden of proof under 39 U.S.C. § 3642(b). To the contrary, the Postal Service's admissions in its November 14 Request and December 16 answers to Chairman's Information Request No. 1, Question 3, and the insensitivity of First-Class Parcels volume to the exigent price increases implemented by the USPS on January 26, 2014, make clear that above-inflation price increases on First-Class Parcels would raise the Postal Service's net earnings. Because the ability to increase prices profitably is conclusive proof of market dominance, the product transfer request must be denied.

¹ USPS Request to Transfer First-Class Mail Parcels to the Competitive Product List (filed Nov. 14, 2014).

The product transfer request must be denied for a further reason: elimination of a market dominant First-Class Mail Parcels product would violate 39 U.S.C. § 3642(b)(2), which requires that all mail products “covered by the postal monopoly” remain classified as market dominant. Raising the price of all First-Class Mail Parcels to at least six times the price of a one-ounce single-piece First-Class letter does not remove the *private* carriage of letters and packets of letters in parcels from the reach of the letter monopoly. Although 39 U.S.C. § 601(b)(1) suspends the letter monopoly when the private carrier charges more than the statutory price floor defined by that section, the suspension does not eliminate the letter monopoly. Private carriage of parcels of letters at prices below the statutory floor is still a crime under 18 U.S.C. § 1696. A product market in which private competitors face prosecution for undercutting the USPS on price cannot be regarded as fully competitive.

I. A MAIL PRODUCT MUST BE CONSIDERED MARKET-DOMINANT IF A PRICE INCREASE WOULD BE PROFITABLE.

We begin with the relevant legal standards. To justify transferring a market dominant product to the competitive product list, the USPS must show that it no longer “exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products.” 39 U.S.C. § 3642(b)(1); 39 C.F.R. § 3020.32(d). Section 3642(b)(1) codifies a standard test for market power—whether a firm, if unconstrained by maximum rate regulation, could increase profits through a small but significant non-transitory increase in price (“SNIPP”). See Order No. 1448 in Docket No. MC2012-14, *Valassis NSA* (Aug. 23, 2012) at 24-25 (quoting Department of Justice/Federal Trade Commission

Horizontal Merger Guidelines); *Mobil Pipeline Co. v. FERC*, 676 F.3d 1098, 1100-1101 (D.C. Cir. 2012); *CF Industries, Inc. v. Surface Transportation Board*, 255 F.3d 816, 821-24 (D.C. Cir. 2001) (citing judicial precedent and antitrust treatises). If such a price increase would increase the firm's profits, the firm has market power.²

As noted by the Commission in the Commercial Standard Mail Parcels decision, "Section 3642(b)(1) is intended to prevent the transfer of market dominant products to the competitive product list if the Postal Service enjoys such market power that it could

² In Docket No. MC2013-57, the USPS suggested that the SSNIP test is inappropriate when existing rates are the product of rate regulation. This claim is unfounded. When the existing rates are the product of rate regulation, it is customary to use those rates as the starting point for the hypothetical rate increase on the ground that regulated rates are designed to approximate a long-run competitive price. See, e.g., *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 14 (2007). As the D.C. Circuit noted in an analogous case, "[i]t is certainly reasonable for FERC to use a cost-of-service computation as an approximation for a pipeline's economic circumstances; the purpose of a cost-of-service rate, after all, is to simulate what a pipeline's economic behavior would be in a competitive market." *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 961 (D.C. Cir. 2007); accord, FERC Stats & Regs. ¶ 31,007, 69 FERC ¶ 61,103 at 31,007 (1994) ("Order No. 572") (quoting *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (1990) ("*Tejas*"), order on reh'g, Order No. 572-A, 69 FERC ¶ 61,412 (1994), pet. for review denied, *Ass'n of Oil Pipelines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1998)); *SFPP, L.P.*, 121 FERC ¶ 61,240 at P 14 (2007) ("*SFPP*"); *Buckeye Pipe Line Company, L.P.*, 53 FERC ¶ 61,473 (1990), order on reh'g, 55 FERC ¶ 61,084 (1991) ("*Buckeye*").

Nor may the SSNIP test be disregarded on the theory that the current or starting prices for First-Class Mail Parcels are noncompensatory. The Postal Service has acknowledged that its existing prices for First-Class Mail Parcels are expected to produce a cost coverage "above 100 percent for FY 2014." USPS Request, Attachment B at 2. "In a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable, and specifically to infer that the price is close to marginal cost, such that the seller makes only a normal return on investment." Market-Based Ratemaking for Oil Pipelines, Order No. 572, FERC Stats. & Regs., ¶ 31,007 at 31,1180 (quoting *Tejas Power Corp. v. FERC*, 908 F.2d 998, 1004 (D.C. Cir. 1990)).

raise rates or reduce service to the detriment of consumers without significant consequences, as defined. Market power might result from constraints on competition due to monopoly powers granted to the Postal Service. Alternatively, market power may be due to extraneous factors that limit the entry of competitors into the marketplace or limit the ability of existing competitors to compete such that the Postal Service would have a free rein to raise rates or reduce service without the steadying hand of competition." Order No. 689 at 14. In the context of the present case, these standards effectively require the USPS to show that significantly raising the price of First-Class Mail Parcels, or significantly degrading the quality of this service, would cause the volume of First-Class Mail Parcels to decline enough to cause a significant decline in the Postal Service's net contribution. *Accord, CF Industries, supra*, 255 F.3d at 822-824.³

The ultimate test, as noted above, is whether a firm can raise its prices significantly without causing the quantity demanded to fall enough to make the price increase unprofitable. *CF Industries, supra*. Direct evidence of the volume effect of actual price changes is the best evidence on this question. Absent such evidence, the

³ The USPS suggests that a price increase may be considered "significant" only if "the percentage increase [is] large enough to force consumers to reevaluate the value of purchasing the product in question." USPS Response to ChIR 1, Question 3(b). This is incorrect. The "small but significant" element of the SSNIP test "is employed solely as a methodological tool for performing the hypothetical monopolist test, and is not a tolerance level for price increases." Merger Guidelines § 4.1.1. The "small but significant" requirement serves only to ensure that the price increase is large enough that its likely volume effects can be predicted with some certainty. Depending on the industry context, as "small but significant" price increase may be five percent, or even less. *Id.*, § 4.1.2. The relevant question from a competitive perspective is not whether the price increase is big, but whether it is likely to be profitable.

Commission may appropriately consider structural evidence on the substitutability of competing products or services offered by private carriers. In that context, the key question is whether the purportedly competing products or services are reasonably interchangeable with the mail service at issue.

The factors considered in evaluating the interchangeability of private carriage with a mail product include: (1) the cross-elasticity of demand between the two products or services; and (2) differences in price, type, grade or quality between the products or services. See *generally*, ABA Section of Antitrust Law, *Antitrust Law Developments* (7th ed. 2012) at 572-589; *Arizona Public Service Co. v. United States*, 742 F.2d 644, 652-53 (D.C. Cir. 1984). Here, the question is whether differences in the price, type, grade or quality of two products cause purchasers to see them as not interchangeable despite their general similarity. *Arizona Public Service Co, supra*, 742 F.2d at 652-53. For example, the Supreme Court has found that championship boxing matches are not reasonably interchangeable with other boxing matches because a lower court found that championship matches drew more spectators at higher ticket prices, sold TV rights for more money, had higher Nielsen ratings and involved salable movie rights. *International Boxing Club v. U.S.*, 358 U.S. 242 (1959); see also *Omni Outdoor Advertising v. Columbia Outdoor Advertising*, 891 F.2d 1127 (4th Cir. 1989), *rev'd on other grounds sub nom. City of Columbia v. Omni Outdoor Adver.*, 499 U.S. 365 (1991) (relevant market for advertising on billboards excluded other modes of advertising delivery such as newspapers, TV and radio). Determining whether purported substitutes are in fact reasonably interchangeable typically requires a highly fact-intensive inquiry into the actual responses of consumers to the different product characteristics and prices. *Antitrust Law Developments* at 580. A claim that one

product is substitutable for another must be supported by substantial evidence, not “conjecture.” *Arizona Public Service Co., supra*, 742 F.2d at 653-55.

The burden of proof rests with a regulated firm that seeks to reclassify a market dominant service as competitive. The Administrative Procedure Act places the burden of proof on the proponent of change. 5 U.S.C. § 556(d) (“Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof.”). Consistent with this, the Commission’s rules place the burden on the Postal Service to “demonstrate why the change” in classification from market dominant to competitive is consistent with the statute. 39 C.F.R. § 3020.32(a). The same principles require that the Postal Service bear the burden of proving that it faces effective competition in each relevant product and geographic market. *Cf.* FERC Stats & Regs. ¶¶ 31,007 at 31,179-80, 69 FERC ¶¶ 61,103 (1994), order on reh’g, Order No. 572-A, 69 FERC ¶¶ 61,412 (1994), *pet. for review denied*, *AOPL v. FERC*, 83 F.3d 1424 (D.C. Cir. 1998) (requiring that an “oil pipeline bear its burden of proof in a fashion that ensures there is no reliance on presumed market forces”); *Gulf South Pipeline Co., L.P., v. FERC*, No. 99-1424 (D.C. Cir., Apr. 23, 2002) (unpublished decision) (party seeking permission to charge market-based rates had the burden of proof to show that it lacked market power and, where it claimed that different products provided effective competition for natural gas transportation, had the burden of proving that the alternative service had a low enough price, and “a quality high enough to treat it as a substitute for” the service at issue).

II. THE POSTAL SERVICE'S OWN CONDUCT CONFIRMS THAT THE POSTAL SERVICE HAS SUFFICIENT MARKET POWER OVER FIRST-CLASS PARCELS TO MAKE ABOVE-INFLATION PRICE INCREASES PROFITABLE.

The record establishes that increasing the prices of First-Class Parcels would increase the Postal Service's net contribution—i.e., that the resulting loss of volume would be smaller than the percentage increase in revenue, and still smaller than the percentage increase in contribution. As noted above, the ability to raise prices profitably is conclusive proof of market dominance.

(1) On January 26, 2014, the Postal Service raised the prices of First-Class Mail Parcels as part of the exigent price increases on virtually all market dominant products. For First-Class Mail Parcels, the average price increase was 11 percent. Docket No. R2013-11, Statement of Altaf Taufique in Support on Behalf of the USPS (Sept. 26, 2013) at 9. When the Postal Service first proposed the increases, it predicted that they would cause the net contribution from First-Class Mail Parcels in Fiscal Year 2014 (annualized by assuming that the exigent rates would be in effect on Oct. 1) to grow from \$72 million to \$132 million. Docket No. R2013-11, Statement of USPS witness Stephen J. Nickerson (revised November 22, 2013), Attachments 24 and 26.

The Postal Service's confidence in the profitability of the price increases was borne out by events. In the third and fourth quarters of Fiscal Year 2014—the first two full quarters after the price increases took effect—the volume of First-Class Mail Parcels declined by only 6.4 percent from the same period of Fiscal Year 2013. See USPS FY 2014, Q3 and Q4 Revenue, Pieces, and Weight reports. A price increase of 11 percent that causes by a volume decline of only 6.4 percent is by definition profitable. Moreover, these figures understate the net gain in overall contribution to the USPS if

some of the lost volume migrated to other USPS products. That almost certainly occurred: as the USPS acknowledges, “postal products rarely have a cross-price elasticity of zero.” USPS Response to ChIR 1, Question 3(b) (filed December 16, 2014).⁴

(2) If the 11 percent increase on First-Class Mail Parcels suggests the existence of market dominance, the Postal Service’s plan to implement *further* above-inflation price increases on First-Class Parcels in the near future, whether or not the Commission agrees to reclassify First-Class Parcels as a competitive product, confirms the existence of market dominance. If the product transfer is approved, the Postal Service states that it will immediately increase all First-Class Parcel prices to at least \$2.94 per piece, ostensibly to remove First-Class Parcels from the postal monopoly. USPS Request, Attachment B at 4-6; USPS response to ChIR 1, Question 3(c).⁵ For lightweight parcels (e.g., those under three ounces), this would be an increase of 62 cents, or nearly *27 percent*—significantly above the rate of inflation. The Postal Services does not believe that this increase “would dissuade many of its current customers from continuing to use the First-Class Package Service Retail product, as prices *would remain well below prices for alternatives.*” USPS Response to ChIR 1, Question 3(c) (emphasis added). Moreover, the Postal Service “would expect

⁴ Moreover, any decline in avoided attributable costs resulting from the decline in mail volume would add further to the profitability of the price increase.

⁵ As discussed in Section IV, *infra*, the contemplated price increase would not actually have this legal effect. Private carriage of matter constituting “letters” or “packets” within the meaning of the Private Express Statutes, at prices below the statutory floor established by 39 U.S.C. § 601(b)(1), would still be a crime.

contribution to rise as a result of the planned price increase,” and “the Postal Service does not expect its market share to materially change” as a result of the increase. *Id.*

Conversely, if the First-Class Mail Parcels remain a market-dominant product, the Postal Service states that “it is likely that” the product “would experience an above average price increase”—i.e., a rate increase greater than inflation—when the Postal Service next imposes CPI-based rate increases on market-dominant mail under 39 U.S.C. § 3622(d). USPS response to ChIR 1, Question 3 (text immediately before table). Again, the Postal Service does not expect that this increase would cause a net loss in contribution. See *id.* (stating that the increase would serve “the Postal Service’s interest in achieving and maintaining cost coverage for the FCMP product”).

The Postal Service’s admitted ability to profit from significant price increases on First-Class Mail Parcels requires denial of the product transfer request as a matter of law. If effective competition existed in any form, demand would be too elastic for a price increase above competitive levels to be profitable. *CF Industries, Inc. v. Surface Transportation Board*, 255 F.3d 816, 821-24 (D.C. Cir. 2001) (citing judicial precedent and antitrust treatises).

III. THE POSTAL SERVICE’S STRUCTURAL ANALYSIS CONFIRMS THE LACK OF EFFECTIVE COMPETITION FOR FIRST-CLASS MAIL PARCELS.

The Postal Service, ignoring the direct evidence that the demand for First-Class Mail Parcels is inelastic enough to make price increases profitable, has focused instead on *structural* evidence of supposed competition. Its November 14 Request asserted that First-Class Mail Parcels face “competition,” mainly from another USPS product, the Priority Mail Flat-Rate Box. Perhaps recognizing the weakness of this claim, the Postal

Service shifted course yesterday. In its Response to Chairman’s Information Request No. 1, Question 3, the Postal Service contended for the first time in this case that First-Class Mail Parcels also face “robust” competition from private parcel carriers such as UPS and FedEx. Both claims are unfounded. Structural evidence, which at best permits inferences about the likely pricing conduct of a firm, cannot trump direct evidence of the firm’s ability to raise prices profitably. In any event, the Priority Mail Flat-Rate Box may not, as a matter of law, be considered a competitor for First-Class Mail Parcels. While private parcel carriers could, in theory, provide effective competition for First-Class Mail Parcels if the price and terms of services of the former were attractive enough, and the geographic coverage of private parcel service were universal enough, the USPS has failed to show that this is so, particularly for lighter-weight parcels, and for parcels sent by consumers and small businesses, or to rural addresses.

A. The Priority Mail Flat-Rate Box Is Not A Competitive Constraint On The Price of First-Class Parcels.

The USPS asserts that competition from the Priority Mail Flat-Rate Box effectively constrains the price of First-Class Mail Parcels. This supposed competition, the USPS contends, means that the USPS

cannot raise First-Class Mail Parcels prices above those for a small Priority Mail Flat-Rate Box; otherwise, First-Class Mail Parcels volume will shift to priority mail. Thus, as a practical matter, *the price for a small Priority mail Flat-Rate Box will effectively act as a cap on the prices for First-Class Mail Parcels.* This will ensure that First-Class Mail Parcels remains the most affordable option for shipping lightweight items.

USPS Request, Attachment B at 6-7 (emphasis added). “Since postal products rarely have a cross-price elasticity of zero,” the Postal Service maintains, it “will have every

incentive to keep the price of First-Class Mail Parcels . . . below the price of the Priority Mail Small Flat-Rate Box.” USPS Response to ChIR 1, Question 3(b).

The Postal Service’s reliance on “competition” from the Priority Mail Flat-Rate Box founders on two independent grounds. First, the prices of First-Class Mail Parcels would have to increase by as much as *150 percent* before exceeding the current prices for Priority Mail Small Flat-Rate Boxes. See ChIR 1, Question 3 (introductory table); USPS response to ChIR 1, Question 3 (restated table). Second, and more fundamentally, the two products, even if close substitutes, cannot be regarded as competitors as a matter of law. Section 3642(b)(1) recognizes competition only from “other” firms. This restriction codifies sound economics. If the Commission exempted First-Class Mail Parcels from maximum rate regulation, the USPS would be free to raise the prices of *both* that product and Priority Mail Small Flat-Rate Boxes *simultaneously*, so as to maximize the *combined* contribution from both. Indeed, that is just what a profit-maximizing monopoly would rationally do if freed from maximum rate regulation.

1. Current prices for Priority Mail Flat-Rate Boxes are too high to serve as an effective constraint on the price of First-Class Mail Parcels at most weight increments.

A supposed competitive constraint that allows price increases of this magnitude could not be considered effective competition even if, contrary to fact, First-Class Mail Parcels and Priority Mail Small Boxes were offered by unaffiliated competitors. The magnitude of the price disparities between the two products precludes treating the latter as an effective competitive constraint. As noted above, the relative price of potential substitute suppliers must be considered. See pp. 5-6, *supra*. This is a corollary of the principle that “Rates that permit exploitation, abuse, overreaching or gouging are *by*

themselves not 'just and reasonable.'" *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984).

Ignoring the higher cost of a putatively competitive alternative supplier is a fundamental error. The entry of alternative sources of supply can be induced for virtually *any* product by raising its price high enough. Entry induced only by this means, however, is not effective competition in any meaningful economic sense; assuming to the contrary is a well-known economic error known as the *Cellophane* fallacy. As Judge Posner has explained:

A monopolist, as we know, always sells in the elastic region of his demand schedule. And one reason that demand schedules have an elastic region is that the higher the price of a product is, the more attractive substitute products become to the consumer. Hence it is not surprising to find a significant cross-elasticity of demand between a monopolized product and other products at the monopoly price-output level.⁶

The USPS tries to minimize the price differential between First-Class Mail Parcels and Priority Mail Small Boxes on the theory that a fair price comparison must include the price of insurance and tracking, which are bundled into the price of Priority Mail, but are extra-cost options for First-Class Mail. The USPS admits, however, that only about "one percent of First-Class Mail Parcel customers also purchased insurance" in Fiscal Year 2014." USPS response to ChIR 1, Question 3(a). Likewise, Delivery

⁶ Richard A. Posner, *ECONOMIC ANALYSIS OF LAW* (4th ed. 1992) § 10.6; W. Kip Viscusi, Joseph E. Harrington, Jr., and John M. Vernon, *ECONOMICS OF REGULATION AND ANTITRUST* 261 (3rd ed. 2000) ("A rational monopolist would, in fact, raise price until its product became a substitute for alternatives. Hence, substitutes in consumption should be evaluated at prices that are reasonably close to marginal costs."); see *also* Philip E. Areeda and Herbert Hovenkamp, John L. Solow, *ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION* (2007) ¶ 539.

Confirmation/USPS Tracking is purchased on only a small minority of First-Class Mail Parcels.⁷ A price increase resulting from tying the purchase of a monopoly product to the purchase of an accessory or ancillary product that customers would not voluntarily buy absent the tying is a price increase.⁸ Indeed, when the seller of the tying product has sufficient market power, the tying can be a *per se* antitrust violation. *Eastman Kodak Co. v. Image Technical Services*, 504 U.S. 451 (1992); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984); *United States v. El Paso Natural Gas Co.*, 60 Fed. Reg. 5217, 5218 (Jan. 26, 1995) (proposed final judgment and competitive impact statement), 1995-2 Trade Cas. (CCH) ¶¶ 71,118 (D.D.C. Aug. 4, 1995) (final judgment).

The Postal Service's assertion that it "has no intention of completely closing the price gap" between First-Class Mail parcel prices and Priority Mail prices is equally beside the point. USPS response to ChIR 1, Question 3(c). First, "trust me" is not a legally permissible ground for exempting a mail product from maximum rate regulation. If the Postal Service "can" raise profitably raise prices faster than inflation, the Commission's inquiry under 39 U.S.C. § 3642(b)(1) is at an end: the product must

⁷ In FY 2013, there were approximately 248 million First-Class Mail Parcels. FY 2013 Revenue, Pieces, and Weight report. Delivery confirmation was only purchased on 23 million of these parcels. Docket No. ACR2013, USPS-FY13-4, FY13 Special Services.xls, "F-11 Delivery Confirmation," Cell C9.

⁸ The Postal Service gains nothing by comparing insurance to the topping on a pizza. USPS response to ChIR 1, Question 3(a). The USPS has offered no evidence that consumers regard more expensive service, bundled with insurance at a price that the overwhelming majority of consumers do not voluntarily pay, as a sufficiently close substitute for cheaper uninsured parcel service to be included in the same product market. In any event, whether the two are included in the same market is ultimately beside the point: the costlier bundled service is costlier, no matter how one slices it.

remain on the market-dominant list. Promises to forbear from fully exploiting the Postal Service's market power are irrelevant.

Second, the Postal Service's statement that "it has no intention of completely closing the price gap between these two products" is illusory. First, the Postal Service's purported commitment is, by its own terms, merely a statement of present intention, which the Postal Service is free to change at any time. The Postal Service has *not* proposed that the Commission condition approval of the requested product transfer on a binding constraint on future price increases. Second, even if the Postal Service could be held to such a commitment, it would still allow massive price increases above inflation. Raising the price of a three-ounce parcel from \$2.32 to \$5.79 does not "completely close the price gap" between \$2.32 and \$5.80, the current price of a Priority Mail Small Box for that weight increment, and thus would be entirely consistent with the terms of the purported commitment.

2. The Priority Mail Small Box product cannot be considered a competitor of the First-Class Mail Parcels product because the USPS sets the prices of both products and receives the revenue from both.

The notion that Priority Mail Small Boxes could provide effective price competition for First-Class Mail Parcels is absurd on its face: the USPS supplies both products, sets the price of both, and receives the revenue from both. If the Commission were to reclassify the latter product as competitive, neither product would be subject to maximum price regulation. At that point, the USPS would be free to raise the prices of both products as much as the market would bear.

The substitutability of one postal product for another does not constitute competition within the meaning of 39 U.S.C. § 3642(b)(1). The potential loss of business cognizable under that section is limited to the “risk of losing a significant level of business to *other* firms offering similar products.” *Id.* (emphasis added). This restriction is consistent with the fundamental axiom of antitrust law and economics that a business enterprise does not compete with itself. See, e.g., 8 Areeda and Hovenkamp, *Antitrust Law* ¶ 1470 (3d ed. 2010); *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984). A rational profit-maximizing multiproduct firm will coordinate the prices of each of its products to maximize its *overall* profits, rather than pricing its products as if each were produced and priced by “independent divisions” of the firm. If expected profits can be increased by raising in tandem the prices of substitute products offered by the same firm, a rational firm will do so. Jean Tirole, *The Theory of Industrial Organization* 70 (1990).

The analytical framework of the Horizontal Merger Guidelines of the Department of Justice and the Federal Trade Commission reflects this fact. The Guidelines provide a framework for predicting how much competition will be lessened when two currently-independent firms merge, and consequently stop competing with each other. The core of the Merger Guidelines—the “hypothetical monopolist test”—examines whether the merged firm, if it behaved as a profit-maximizer, could profitably “impose at least a small but significant and non-transitory increase in price (‘SSNIP’) on at least one product in the market, including at least one product sold by one of the merging firms.” DOJ/FTC Horizontal Merger Guidelines § 4.1 (August 19, 2010); accord, Order No. 1448, Docket No. MC2012-14, *Valassis NSA* (August 23, 2012) at 24-25 (quoting Merger Guidelines). The very premise of the SSNIP test—and the Merger Guidelines generally—is that two

formerly independent economic entities, once under common ownership and control, will no longer compete with each other, and that any competition will need to come from other firms. *Id.* For Priority Mail Small Boxes and First-Class Mail Parcels, the “hypothetical monopolist” assumption of the Merger Guidelines is a *fait accompli*: the two products are *already* produced by the same entity, and under the same management. The only barrier to raising the prices of both is the maximum rate regulation that Section 3622 imposes on First-Class Mail Parcels as a market-dominant product. Reclassifying the product as competitive would leave the USPS free to raise the prices of both products in tandem.

B. Private Parcel Carriers Such As UPS And FedEx Offer Service Do Not Provide Effective Competition For First-Class Parcels, Particularly For Retail Customers And In Rural Markets.

The Postal Service’s reliance on competition from private parcel carriers such as UPS and FedEx is equally unfounded. USPS responses to ChIR 1, Question 3(b)(ii) and 3(c).

First, the Postal Service’s reliance on competition from private carriers is essentially an afterthought. The Postal Service’s November 14 Request, while mentioning UPS and FedEx in passing (Request, Attachment B at 6), offered no analysis of the prices, terms of service, and geographic availability of parcel shipping services offered by any private carrier. The Postal Service conceded that First-Class Mail Parcel service is used disproportionately by “small businesses and individual consumers,” that private parcel carriers have a “long-established practice” of assessing “surcharges on deliveries to rural communities,” and that many residents of rural communities are “without a competitive package delivery market.” *Id.* at 3, 7.

Consistent with this, the Postal Service’s analysis of why reclassification of First-Class Mail Parcels supposedly would not lead to significant price increases focused entirely on “competition” from the Priority Mail Flat-Rate Box, not private carriage. *Id.* at 7.⁹

In response to Chairman’s Information Request No. 1, Question 3(b)—filed *one day* before the filing deadline for the mailers’ initial comments—the USPS has belatedly changed its position. The USPS now asserts that private competition in the “parcel market” is “robust,” and that “the Postal Service would likely lose business to competitors if it were to close the gap between the prices for First-Class Mail Parcels and the price of a Small Flat-Rate Box.” *Id.*, Questions 3(b), 3(c). This 11th-hour maneuver gains the Postal Service nothing. By its own admission, the minimum prices

⁹ The USPS did cite an unpublished analysis by The Colography Group, a consultant to the USPS, offering the conclusory observation that First-Class Package Service, including First-Class Mail Parcels volume, would have a relatively small “market share” of the “2-3 Day Air” and “Ground” parcel markets for “retail and commercial customers.” *Id.* at 3-4 (citing “The Colography Group”). The USPS has not disclosed the assumptions, data or methodology underlying these conclusions. Without full disclosure of this information—including but not limited to an explanation of how the consultant analyzed the price, terms of service, and geographic scope of specific competitive options available to consumers, small businesses, and rural mailers—the conclusions of the study are entitled to no weight. Reliance on this analytical black box would be unlawful. “Due process includes the right to know what evidence is being used against one and the opportunity to rebut it.” *Robbins v. United States R.R. Retirement Bd.*, 594 F.2d 448, 452 (5th Cir. 1979). “Notice remains a fundamental element of procedural due process, and trial by ambush is no[t] . . . favored” *Jimenez v. Tuna Vessel “Granada”*, 652 F.2d 415, 420 (5th Cir. 1981) (quoted in *Conair Corp. v. NLRB*, 721 F.2d 1355, 1372 n. 60 (D.C. Cir. 1983)).

The poor quality of the market analysis submitted by the same consultant (The Colography Group) in the DVD product transfer case provides further grounds for skepticism about accepting the same consultant’s analysis in the present case sight unseen. See Docket No. MC2013-57, Supplemental Comments of GameFly, Inc. (filed September 12, 2013) at 24-26 (discussing Colography Group study).

for the UPS and Fed Ex parcel services, \$6.24 and \$7.50, respectively, are double or triple the prices of First-Class Mail Parcel at most weight increments. *Id.*¹⁰ Moreover, the Postal Service has offered no data or analysis addressing the concerns that the Postal Service itself acknowledged about the limited effectiveness of competition from private parcel carriers for consumers, small businesses, and rural residents.

The Postal Service tries to gloss over this failure of proof on the theory that, because “large commercial mailers are using both First-Class Mail Parcels and First-Class Package Service,” “these products serve a single marketplace, and ought to be combined.” Request, Attachment B at 3. The Postal Service acknowledged yesterday, however, that “single-piece and bulk mailers do occupy separate markets.” USPS Response to ChIR No. 1, Question 3(e)(i). First-Class Mail Parcels service in rural areas is likely to define separate geographic markets as well. Antitrust precedent holds that, where product markets are split into sub-markets by differences in product characteristics or consumer preferences, a “core group of particularly dedicated, ‘distinct customers,’ paying ‘distinct prices,’” may constitute a distinct market that must be analyzed separately. *FTC v. Whole Foods*, 548 F.3d 1028, 1039 (D.C. Cir. 2008); *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1078-79 (D.D.C. 1997); *Meredith Corp. v. SESAC, LLC*, 2011 WL 856266 (S.D.N.Y. 2011). Similarly, if competitors operate in some geographic markets but not others, the latter markets must be analyzed

¹⁰ Furthermore, the UPS and FedEx rates cited by the Postal Service are clearly minimum rates. According to the rate schedules to which the Postal Service cites, these rates are offered only for shorthaul categories -- “local” and “Zones 2” -- and exclude surcharges. Additionally, the UPS rates are for Ground even though the Postal Service also lists higher-price 2-Day Air and 3-Day Air as competitors of the First-Class Mail Parcel service.

separately from the former. See, e.g., Merger Guidelines § 4.2 (a market “may be geographically bounded if geography limits some customers’ willingness or ability to substitute some products, or some suppliers’ willingness or ability to serve some customers”); cf. *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1508 n. 50 (D.C. Cir. 1984) (if competing sources of transportation are not “omnipresent,” competition “must be evaluated in terms of discrete regional markets”).

It is too late for the Postal Service to remedy these deficiencies in its reply comments. The Postal Service should have provided the missing analysis as part of its initial Request in this docket, so that mailers and other commenting parties would have received adequate notice and opportunity to respond. Particularly in light of the Postal Service’s opposition to “an extension of the comment deadline in this proceeding” for other parties,¹¹ giving weight to additional evidence that should have been part of the Postal Service’s case-in-chief, but which surfaces for the first time in the Postal Service’s reply comments, would be a violation of the other participants’ due process rights.

IV. THE POSTAL SERVICE MUST MAINTAIN A MARKET-DOMINANT PRODUCT OF FIRST-CLASS PARCELS FOR MATTER THAT CONSTITUTES A “LETTER” UNDER THE PRIVATE EXPRESS STATUTES.

The product transfer request must be denied for a further reason: elimination of a market dominant First-Class Mail Parcels product would violate 39 U.S.C. § 3642(b)(2). Section 3642(b)(2) requires that mail products “covered by the postal monopoly” remain classified as market dominant. For purposes of this restriction, a

¹¹ USPS Response to ChIR 1, Question 3 (cover page).

“product covered by the postal monopoly” means “any product the conveyance or transmission of which is reserved” to the Postal Service under 18 U.S.C. § 1696, the general private express statute, unless the exception stated in the last sentence of 39 U.S.C. § 409(e)(1) applies. 39 U.S.C. § 3642(b)(2). The last sentence of 39 U.S.C. § 409(e)(1) “any private carriage of mail allowable by virtue of [39 U.S.C.] section 601 shall not be considered a service reserved to the United States under section 1696 of title 18.” And 39 U.S.C. § 601(b)(1) in turn provides that a letter may be “carried out of the mails” when “the amount paid for the private carriage of the latter is at least the amount equal to 6 times the rate then currently charged for the 1st ounce of a single-piece first class letter.”

The Postal Service, seizing upon the last of these provisions, asserts that, if *its* prices for First-Class Mail Parcels all satisfy the 6-times-the-one-ounce-first-class-letter price test of Section 601(b)(1), then 39 U.S.C. § 409(e)(1) is satisfied, thereby satisfying 39 U.S.C. § 3642(b)(2) as well. USPS Request, Attachment B at 4-6. The flaw in this reasoning is that the 6-times-the-one-ounce-first-class-letter price floor of 39 U.S.C. § 601(b)(1) applies not to the Postal Service’s prices, but to those charged by *private competitors*. Since, as the Postal Service concedes, some First-Class Mail Parcels are likely to contain matter that constitutes “letters” under 39 C.F.R. § 310.1 and does not fall within other exemptions to the Private Express Statutes, a private carrier that carries such matter still faces the risk of criminal prosecution for carrying such matter unless the private carrier’s prices equal or exceed the 6-times-the-one-ounce-first-class-letter price floor. Carriage of “letters” by private companies at lower prices is still subject to the postal monopoly. Stated otherwise, the “private carriage of” letter at prices below six times the one-ounce single-piece First-Class letter rate is *not* “allowable by virtue of”

39 U.S.C. § 601(b)(1), and thus still must be “considered a service reserved to the United States under section 1696 of title 18” under the last sentence of 39 U.S.C. § 409(e)(1). What the Postal Service charges for its own First-Class Mail Parcel product is irrelevant to this legal restriction.

This is more than a technical or formal objection. The purpose of 39 U.S.C. § 3642(b)(2) was to preclude postal products from being reclassified as competitive—and thereby exempted from maximum rate regulation—unless effective competition from private carriers is genuinely allowed. An exemption to the postal monopoly that permits private carriers to compete with First-Class Mail Parcel service only if they do not compete by undercutting its price results at best in competition with its wings clipped. A legal regime that forbids private firms, under threat of criminal prosecution, from undercutting the prices of an incumbent monopoly is likely to produce perversely anticompetitive results unless the prices of the incumbent monopoly are subject to maximum rate regulation. *Cf.* 2 Alfred E. Kahn, *The Economics of Regulation* 209-220 (1971) (discussing the distortive effects of allowing only non-price competition in the airline industry before deregulation).

CONCLUSION

For the foregoing reasons, the Postal Service's product transfer request should be denied.

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December 17, 2014